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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 916

LUCKENBACH STEAMSHIP COMPANY, INC., a corporation,

Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Appellee.

On Appeal from the District Court of Appeal, Third Judicial District, State of California

Jurisdictional Statement

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On Appeal from the District Court of Appeal, Third Judicial District, State of California

Jurisdictional Statement

JURISDICTION

This action was brought in the Superior Court in and for the County of Sacramento, State of California, pursuant to Cal. Rev. & Tax Code § 26102, (Cal. Stats. 1949, ch. 557, § 1, p. 1036-7) for the recovery of state income tax on the ground, among others, that the California Corporation Income Tax Act pursuant to which the tax was collected is unconstitutional as applied. After decision by the Superior Court appeal was taken by the taxpayer to the California District Court of Appeal whose opinion affirming

the Superior Court was filed September 3, 1963 (219 Adv. Cal. App. 783, 33 Cal. Rptr. 544). Hearing by the Supreme Court of the State of California was denied on October 23, 1963. Notice of this appeal was filed in the District Court of Appeal on January 17, 1964.

The jurisdiction of the Supreme Court of the United States to review this decision by appeal is conferred by the provisions of 28 U.S.C. § 1257 (2), 62 Stat. 929. The following decisions sustain the jurisdiction of the Supreme Court to review the judgment on appeal in this case: *Marcus v. Search Warrant*, 367 U.S. 717, 721 (1961); *Dahnke-Walker Co. v. Bondurant*, 257 U.S. 282 (1921).

The statutes involved are Cal. Stats. 1943, ch. 351 § 3, p. 1348; Cal. Stats. 1939, ch. 1049 § 3, p. 2903 and § 10, p. 2921 which impose a net income tax. The relevant portions of the texts thereof are as follows:

> "Sec. 3. There shall be levied, collected and paid for each taxable year, a tax * * * upon the net income of every corporation derived from sources within this State * * *. Income from sources within this State includes income from tangible or intangible property located or having a situs in this State and income from any activities carried on in this State, regardless of whether carried on in intrastate, interstate or foreign commerce."
>
> * * * * * * *
>
> "Sec. 13. In the case of corporations owning property or engaging in business or activities both within and without the State, the net income derived from sources within this State shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, payroll, value and situs of tangible property or by reference to any of these or other factors or by such other method of allocation as is fairly calculated to determine the net income from sources within this State. Income from business carried on partly within and partly without this State

shall be allocated in such manner as is fairly calculated to apportion such income among the States or countries in which such business in conducted."

QUESTIONS PRESENTED

1. Are Cal. Stats. 1943, ch. 351 § 3 at 1348; Cal. Stats. 1939, ch. 1049, § 3 at 2903 and § 10, p. 2921 constitutional under the due process clause (Section 1 of the Fourteenth Amendment to the United States Constitution) when applied to confer jurisdiction on California to tax income earned by appellant, a foreign corporation, from the operation of its vessels on the high seas?

2. Are the above cited statutes constitutional under the interstate commerce clause (Clause 3, Section 8 of Article 1 of the United States Constitution) when applied so that California taxes the income of appellant, a foreign corporation, earned by appellant while engaged in interstate commerce on the high seas?

STATEMENT OF THE CASE

The case was tried on stipulated facts. Those most relevant to this appeal are set forth in paragraphs 1 through 4 and 28 (Tr. pp. 49, 50, 64-66) of the Stipulation of Facts.

Appellant is a steamship company incorporated in Delaware having neither legal nor commercial domicile in California, which operates its steamships on the high seas between various states, including California, and in foreign commerce. The issue in this case relates to the proper method of determining what portion of appellant's income is taxable by California. There is no dispute that appellant is engaged in a "unitary business" and, therefore, that its income derived from California sources should be determined by use of an allocation formula. There is also no dis-

pute that the customary three-factor formula of property, payroll and sales (receipts) is a proper formula to use.[1] This case differs from the ordinary allocation case in that appellant's property (its steamships) moves in and out of California, and its employees (seamen) similarly move in and out of California. Thus, whereas in the ordinary unitary business the California property which appears in the numerator of the property factor is property which is permanently located in California, and the California payroll which appears in the numerator of the payroll factor is wages paid for services rendered entirely in California, in the case of a steamship company such as appellant it is necessary to determine how much of the vessel value shall be considered as located in California and included in the numerator of the property factor, and how much of the ship's payroll shall be considered earned in California and included in the numerator of the payroll factor.

1. Under this formula, three "factors" (usually taxpayer's property, payroll and revenues) are taken to be instrumental in, and a fair measure of, the production of the income of its unitary business. The percentage of the total value of each of the three factors located within the taxing state is computed, viz., the percent of taxpayer's total property located within the taxing state, the percent of taxpayer's total payroll located in the taxing state and the percent of taxpayer's total revenue derived in the taxing state. (Alternatively these "percentages" are often spoken of as fractions in which the numerators are the values of taxpayer's property, wages and revenues located in the state and the denominators are taxpayer's total property, wages and revenues wherever located.) The average of these three percentages is then determined and is considered to be the portion of the total income of the unitary business which has its source within the taxing state. See generally, for the theory and principles of formula allocation, Butler Bros. v. McColgan, 315 U.S. 501, 86 L. Ed. 991, 62 S. Ct. 701 (1942); Hartman, State Taxation of Corporation Income, 13 Vanderbilt Law Review 20 (1959); Altman & Keesling, Allocation of Income and State Taxation (2d Ed 1950); Keesling and Warren, the Unitary Concept in the Allocation of Income, 12 Hastings Law Journal 22 (1960); Wahrhaftig, Allocation Factors in Use in California, 12 Hastings Law Journal 65 (1960).

Appellant, in filing its returns, included in the numerators of the property and wage factors, respectively, that portion of the vessel values and wages equivalent to the portion of the taxable year which the vessel spent in California.

Appellee, Franchise Tax Board, however, noting that appellant's vessels traverse the high seas as well as the territory of this and other taxing jurisdictions grafted onto the allocation formula what is known as the "port day" assumption, pursuant to which it included in the numerator of the property factor that portion of the value of a vessel which the number of days it spent in California *ports* bore to the number of days such vessel spent in all *ports*, and in the numerator of the wage factor that portion of the total wages paid to the officers and crew of a vessel which the number of days the vessel spent in California *ports* bore to the number of days it spent in all *ports*. The "port day assumption" thus assumes that all vessels are always either in California ports or other ports, but never on the high seas. The use of this assumption will hereafter be referred to as "port day allocation". Allocation based on actual location throughout the year will be called "voyage day allocation."[2]

The effect of these two methods is illustrated in the example below:

Portion of year Vessels are in California Ports	Portion of Year Vessels are at Sea	Portion of Year Vessels are in Other Ports
20% (or 73 days)	60% (or 219 days)	20% (or 73 days)

2. In some of the years in question certain revenues e.g. time charter hire, were also treated by the parties as subject to port or voyage day allocation. There is no dispute as to how the port or voyage day method is to be applied, the only dispute being as to which of them is lawful.

Under the "port day" assumption, the portion of the total appropriate vessel values and payroll attributable to California is computed as follows:

$$\frac{\text{California Port time}}{\text{Total Port time}} = \frac{20\%}{40\%} \left(\text{or } \frac{73 \text{ days}}{146 \text{ days}} \right) = 50\%$$

Under the voyage day formula the computation would be:

$$\frac{\text{Time in California}}{\text{Total time anywhere}} = \frac{20\%}{100\%} \left(\text{or } \frac{73 \text{ days}}{365 \text{ days}} \right) = 20\%$$

The constitutionality of the Board's refusal through the use of the "port day" assumption to give any recognition to the fact that the vessels are employed in productive operations on the high seas is the sole issue to be resolved in this case.

How the Federal Question Is Presented.

The constitutional issues were raised at every stage of the proceedings below. In appellant's claim for refund filed with the Franchise Tax Board on April 10, 1953, the unconstitutionality of the "port day" assumption was asserted in paragraphs 3 and 7 (Tr. pp. 35, 36 and 38). It was pleaded in plaintiff's complaint in the trial court in paragraphs VIII. (2)• and IX for the year 1942, which were incorporated by reference into appropriate paragraphs of the causes of action for the years 1943 to 1947, inclusive (Tr. pp. 13, 14 and 15).

In its opening brief in the trial court appellant asserted (p. 28):

> "The use of the so-called 'port day' formula as a means of attributing vessel assets, wages and certain revenues to California for use in the three-factor allocation formula necessarily allocated to California income from sources outside the state contrary to the taxing statute and the Constitution."

Appellee's brief replied that (p. 31) "the problem here presented is purely a matter of constitutional law."

The trial judge, after construing the California statute (§ 13 of the Corporation Income Tax Act) as requiring the use of the "port day" method, said (Tr. p. 107), "But the question remains: So construed is the provision constitutional?" He ruled that it was.

In the California District Court of Appeal the constitutional issue was raised by appellant in its Opening Brief (p. 3):

> "This issue, however, is principally a constitutional one, viz., the validity under the due process clause of the Fourteenth Amendment to the Constitution of the United States, and also under the Commerce Clause, of the manner in which respondent Franchise Tax Board applied its allocation formula to determine the source of appellant's income."

The constitutional issue was met by appellee:

> "Respondent [appellee here] further contends that such an apportionment formula does not offer any constitutional inhibitions." (Br. for Resp. p. 2)

Virtually the entire opinion of the District Court of Appeal, which is reprinted in the Appendix, is an attempt to support the constitutional validity of the "port day" assumption.

Finally, in appellant's petition for hearing by the California Supreme Court, which was denied without opinion, the principal argument advanced by appellant was summarized as follows (p. 7):

> "In the ensuing discussion petitioner will demonstrate (a) that no state can tax the extra-territorial income of non residents and that this is true without regard to whether such income is earned in other states or outside the jurisdiction of all states; (b) that a

> portion of petitioner's income-producing activities takes place on the high seas and an allocation formula which systematically appropriates this activity to the taxing state violates the due process clause."

Appellee's answer to the petition states (p. 3):

> "Since petitioner does not claim that the "port day" formula does not produce the result which it was designed to produce, i.e., a fair apportionment of a steamship company's income between the various states and countries in which that business is conducted, it is clear that the only issue raised by petitioner is whether such an allocation objective is in accord with established constitutional principles."

The denial of appellant's petition for hearing by the Supreme Court of California necessarily constituted a ruling that the statute, as applied, was not repugnant to the United States Constitution.

THE QUESTIONS PRESENTED ARE SUBSTANTIAL

A. The Due Process Question.

The logic of appellant's case so far as due process is concerned involves two propositions: first, that no state may tax the income of a non-resident derived from activities outside its boundaries, and second, that the port day method of allocation necessarily taxes income derived from such activities, namely, from operations on the high seas.

(1) A state cannot tax extra-territorial income.

The proposition that a state cannot, under the due process clause, tax extra-territorial income of a foreign corporation is an elementary one which, so far as appellant is aware, has never before been seriously challenged. In

James v. Dravo Contracting Co., 302 U.S. 134, 138 (1937), this Court stated:

> "As to territorial jurisdiction. —Unless the activities which are the subject of a tax were carried on within the territorial limits of West Virginia, the state had no jurisdiction to impose the tax."[3]

And in *Connecticut General Ins. Co. v. Johnson*, 303 U.S. 77, 80-81 (1938), the due process limits on a state's jurisdiction to tax were discussed as follows:[4]

> "We look to the state power to control the objects of the tax as marking boundaries of the power to lay it. Hence . . . a state which controls the . . . activities within its boundaries . . . may tax them.
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> * * * * * * *
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> "The performance of those acts (taking place outside of the state) was not dependent upon any privilege or authority granted by it, and California Laws afforded to them no protection.
>
> * * * * * * *
>
> "(Hence) the tax cannot be sustained either as laid on property, business done, or transactions carried on within the taxing state, or as a privilege granted by the state."

In an unbroken line of decisions since *U.S. Glue Co. v. Town of Oak Creek*, 247 U.S. 321 (1918) this Court has sustained taxes imposed on net income derived from within the state[4] and struck down taxes imposed on extra-territorial income.[5] These decisions are based on the principle

3. This case is particularly apposite because the area in question was a Federal enclave geographically located in West Virginia. The Court held that if the state had divested itself of jurisdiction over the area, income from sources therein could not be taxed at all by any state.

4. Butler Bros. v. McColgan, 315 U.S. 501 (1942); Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920); Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission, 266 U.S. 271 (1924).

5. Hans Rees' Sons v. North Carolina, 283 U.S. 123 (1931).

that a state may tax income only if it can be said to have resulted from activities or property within the state's borders,[6] a principle which was confirmed in *Northwestern Cement Co. v. Minnesota*, 358 U.S. 450, 464 (1959) where the Court held that taxes, though levied on income exclusively derived from interstate commerce, violate neither the commerce nor due process clauses if they "are levied only on that portion of the taxpayer's net income which arises from its activities within the taxing state."

(2) Port day allocation necessarily taxes income from sources outside the state.

Port day allocation is designed to and does, for tax purposes, divide up among the port states 100% of the income of steamship companies. It necessarily follows that its use results in the taxation of income from sources outside the taxing states if and to the extent there is any income from sources other than ports.

That a steamship company's income is earned at least in part on the seas and not entirely in ports is sufficiently obvious as not to require extensive analysis. Such an analysis if made, however, will show that the attribution of steamship company income in part to the sea follows necessarily from the basic principle upon which formula alloca-

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6. The rule has also been enunciated and applied by a number of state courts, e.g. Southern Pacific Company v. McColgan, 68 Cal. App. 2d 48, 60 (1945), People v. Travis (1921) 231 N.Y. 339, 132 N.E. 109; Gross Income Tax Division v. Fort Pitt Bridge Works (Ind. 1949) 86 N.E. 2d 685; Newport Co. v. Wisconsin Tax Commission (1935) 219 Wis. 293, 261 N.W. 884, cert. den. 297 U.S. 720; State v. Burnett (1940) 200 Ark. 665, 140 S.W. 2d 673; A. P. Green Firebrick Co. v. Missouri State Tax Commission (Mo. 1955) 277 S.W. 2d 544; Montgomery Ward Co. v. State Tax Commission (1940) 151 Kan. 159, 98 P.2d 143; New Mexico Glycerine Co. v. Gallegos (1944) 48 N.M. 65, 145 P.2d 995; Marshall-Wells Co. v. Commissioner of Taxation (1945) 220 Minn. 458, 20 N.W. 2d 92.

tion is founded, viz., that the income of a unitary business has its source at the locations of its properties and activities.[7] This identity between the location of the factors and the source of the income to be allocated by them is inherent in the decisions of this Court which make it clear that the constitutional basis for the use of formulas is the fact that property, wages and receipts are fair measures of the extent to which the state has contributed[8] to the total profits of the unitary enterprise through the protection, opportunities, and benefits[9] it has afforded. Port day allocation negates this identity, and therefore the basis for the use of the formula itself, by treating properties, wages and receipts as having been located within the state when in fact they were located elsewhere.

In *Greyhound Lines v. Mealey*, 334 U.S. 653 (1948), this Court expressly held that the income of a transportation company is earned and has its source along the routes which it travels, as well as at its termini.[10] If a transportation company's income has its source partly along the routes that it travels when those routes are in a taxing jurisdiction, its income no less has its source on such routes when they are on the high seas. Source of income is not dependent upon political status.

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7. Paul J. Hartman, State Taxation of Income from Multi-State Business, 13 Vanderbilt L. Rev. 20, 63 (1959).

8. Butler Bros. v. McColgan, 315 U.S. 501, 504, (1941).

9. Wisconsin v. J. C. Penney Co., 311 U.S. 435, 444, (1940). See also Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 465, (1958); Ott v. Mississippi Valley Barge Lines, 336 U.S. 169, 174, (1949); cf. Norfolk & Western Ry. Co. v. North Carolina, 297 U.S. 682, 688 (1936).

10. The bus route in question was between two points in New York but passed through New Jersey and Pennsylvania. The precise holding was that New York could not tax all of the income from this route because the other two states could, as Pennsylvania did, tax the portion of such income attributable to mileage within their borders.

To graft the port day assumption on the basic three-factor formula is systematically and inevitably to treat taxpayer's property, wages and receipts as if they were located in California when in actual fact they were not and, therefore, to tax income from sources outside of California by arbitrarily treating it as if its source were within the state.[11] In short the formula by its own terms taxes extra territorial income.[12]

(3) The State's Position: A state has power to tax income from sources outside its boundaries so long as such income is not subject to taxation by another governmental body.

The conclusion being inevitable that income from property and activities on the high seas has its source there, appellee is driven to challenge the basic rule itself, viz., that a state's jurisdiction to tax is limited to income from sources within its boundaries. It therefore asserts an entirely new concept of constitutional law, namely, that a state has jurisdiction to tax income from sources outside its boundaries so long

11. Justice Cardozo, when sitting on the Court of Appeals for the State of New York, addressed himself to this problem, in a case involving a formula which arbitrarily limited the out-of-state property of taxpayer, as follows:
"To take from assets elsewhere is equivalent to adding to assets here. The statute would be little different in principle if it announced the arbitrary rule that all investments in bonds and stocks should be conclusively presumed to have their situs in New York. *The resulting vice in the proportion is not the consequence of adventitious circumstances, of inequalities developing unexpectedly in the practical workings of the statute, but hardly to be avoided by reasonable foresight.* The exclusion of bonds and stocks is the result of an explicit mandate. *The principle of allocation is not followed to its natural and obvious outcome in accordance with the situs of the assets, but is consciously checked, its normal course thwarted, by an artificial and designed exception.*" (Emphasis added.) People ex rel. Alpha Portland Cement Co. v. Knapp, 230 N.Y. 48, 129 N.E. 202, 1206 (1920), cert. denied 256 U.S. 702.

12. Gulf Oil Corp. v. Joseph, 307 N.Y. 342, 121 N.E. 2d 360 (1954) appeal dismissed 348 U.S. 923.

as the income from such sources is not subject to tax by any other state.

Appellee argues that the due process clause does not impose any requirement of territorial jurisdiction to tax but "requires no more"[13] than apportionment of income among all taxing jurisdictions. In short, due process imposes only a requirement of *apportionment* and not a requirement of *source*. The argument is most succinctly stated in appellee's answer to appellant's Petition for Hearing by the Supreme Court of California as follows (p. 5):

> "It is undisputed that the 'port day' formula, when used as an adjunct to the usual three-factor formula of property, payroll and revenues, has the effect of apportioning the unitary income of a steamship company between the various states and countries in which that company does business. Such an *apportionment method* reflects the extent of the company's activities in California *in relation to its total activities in all states and countries in which it does business*. Accordingly, California only taxed that portion of a steamship company's unitary income which was fairly attributable to California activities *as compared to the company's activities in all the states and countries in which it did business. Due process requires no more.*" (Emphasis added)

This erroneous theory that due process "requires no more" than an apportionment of income among taxing jurisdictions is repeated no less than five times in appellee's brief before the California District Court of Ap-

13. See quotation from appellee's Answer to Petition for Hearing by California Supreme Court next following.

peal[14] and is the heart of appellee's argument.[15] It is also advanced (again in appellee's answer to appellant's Petition for Hearing before the Supreme Court at page 14) in the discussion of *Greyhound v. Mealey*, supra, which appellee attempts to distinguish from the instant case solely on the ground that in the Mealey case, "there was present (along the route) a jurisdiction able to tax (whereas) the 'high seas' cannot tax . . ."

The result of this analysis is to eliminate territorial due process as a constitutional limitation on the state's power to tax.

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14. Appellee's brief, pages 2, 3, 15, 18 and 20. Following are examples:

Appellee's Brief, page 18: ". . . in relation to its total activities in all states."

Appellee's Brief, page 20: ". . . in relation to the total amount of protection, benefits and opportunities afforded a steamship company."

Appellee's Brief, page 3: ". . . as compared to appellant's activities in all states and countries."

15. Appellee's erroneous analysis has its source in a 1942 opinion of the California Attorney General approving port day allocation as being constitutional because it is "consistent with the principle that a state does not have territorial jurisdiction to tax income of a foreign corporation which is derived from sources within other states or countries. This principle is designed to prevent unlimited double taxation and is implied from the Constitution" Op. of California Atty. Gen. N. S. 4344, June 5, 1942. Of course, there is no such "principle". Territorial jurisdiction to tax limits the taxing state to sources *within its boundaries*, and does not merely prevent taxation of income from sources *in other states*. Apparently the author confused Commerce Clause principles, under which the existence of "multiple burdens" on interstate commerce is paramount, see e.g. Northwestern Cement Co. v. Minnesota, 358 U.S. 450 (1958), with due process considerations involving territorial jurisdiction, Wisconsin v. J. C. Penney Co., 311 U.S. 435, 444 (1940), under which double taxation is immaterial. State Tax Commission v. Aldrich, 316 U.S. 174, 178 (1942). As stated in Ill. Cent. R. Co. v. Minnesota, 309 U.S. 157, 164 (1940), the "Fourteenth Amendment no more forbids double taxation than it does doubling the amount of tax; short of confiscation of proceedings unconstitutional on other grounds."

The battle lines are, therefore, clearly drawn. Appellant asserts that the due process clause limits a state's taxing jurisdiction to income from sources within its borders, whereas appellee asserts that, at least within the limits of the port day allocation, it may tax income from sources outside its borders, and it has done so.

B. The Commerce Clause Question.

Where a tax violates due process by taxing income earned in interstate commerce from sources outside the boundaries of the state, it also violates the commerce clause as an unreasonable burden on interstate commerce. While the exact relationship between commerce clause and due process considerations in state tax cases has not been the subject of exhaustive analysis by this Court, the foregoing general proposition has been assumed in numerous instances—and with good reason, for if states were allowed to tax income from outside their boundaries the danger of multiple burdens on interstate commerce is obvious. Particularly is this true where the tax is on instrumentalities of commerce, such as interstate transportation or communications.

Appellee's contention, in substance, is that port day allocation avoids conflict with the commerce clause because it taxes only that portion of high-seas income equivalent to California's portion of total vessel port time. It will be shown, however, that this argument is erroneous. The port day formula (1) does not avoid the risk of multiple taxation and (2) affirmatively burdens interstate commerce by erecting an unreasonable tariff barrier between the states proportionate in magnitude to the distance between them, thus discriminating against shippers from more distant states.

1. Port day allocation involves the risk of multiple taxation of income earned in interstate commerce.

If one state can tax a portion of high seas income so can they all. While California might choose to limit itself to taxing only that portion of high seas income equivalent to its portion of total vessel port time, it can neither assume that other states will do the same nor prevent them from taxing more.

California has argued that appellant must show that other states have in fact taxed high seas income to the point of multiple taxation; but the suggestion runs counter to principles laid down by this court as well as to sound judicial administration.

> "But that, for the time being, only one state has taxed is irrelevant to the kind of freedom of trade which the Commerce Clause generated. The immunities implicit in the Commerce Clause and the potential taxing power of a state can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various states at a particular moment." *Freeman v. Hewitt*, 329 U.S. 249, 256 (1946)
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> "But even if neither Pennsylvania nor New Jersey sought to tax their proportionate share of the revenue from this transportation, such abstention would not justify the taxing by New York of the entire revenue." *Greyhound Lines v. Mealey*, 334 U.S. 653, 663 (1948)
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> "It is no answer to suggest that the states other than Minnesota have not asserted their constitutional power to tax or that we do not know how or to what extent they have exercised it. The extent to which one state may constitutionally tax the instruments of interstate transportation does not depend upon what other states may happen to do, but upon what the taxing state has constitutional power to do . . . It is enough that the tax exposes petitioner to 'the risk of a multiple burden . . .'" Stone, C. J. dissenting in *Northwest Airlines v. Minnesota*, 322 U.S. 292, 326 (1943).

2. Port day allocation discriminates against long hauls, thus setting up tariff barriers proportionate to the length of the sea voyage between states and impeding the free flow of commerce.

Port day allocation attributes to the terminal states a portion of the assets, wages and revenues located, and, therefore, income earned, on the high seas. Accordingly, the greater the proportion of sea time while the ship is out of the state, the greater the portion of the income that is subject to tax by the state and the higher the freight charges to the shipper.

A single example will demonstrate both the inherent unreasonableness of port day allocation and its discriminatory effect on commerce from distant states.

Consider two steamship corporations engaged in interstate commerce, as appellant is, one of which transports goods from New York to California and the other transports goods from Washington to California. For simplicity, it is assumed that the net annual income per ship is the same; that all the ships are of the same size and speed and both stay in port for one day at each end of each voyage; and that a round trip for a New York ship takes 40 sea days, or ten times as long as one for a Washington ship which takes only 4 sea days. Each ship may also be considered as spending half its port days in California ports, and the other half in Washington ports or New York ports.

The unreasonableness of the port day assumption can be seen from an analysis of its application to these two steamship companies. Insofar as the Washington steamship corporation is concerned, under the port day assumption California will treat 50% of the value of the vessel, crew's wages and certain revenues as California assets, wages and revenues, and 50% of the net income as taxable to California, despite the fact that the vessel was in California and

enjoying the opportunities, protections and benefits thereby afforded only 1/6 of the time.

Now contrast the application of the port day assumption to the steamship corporation transporting goods from New York to California and whose vessels spend 40 days per round trip on the high seas and one day in port at each end. It will be observed that here again, under the port day assumption, California will tax 50% of this corporation's income even though the vessel is in California enjoying its opportunities, protections and benefits in this instance approximately 9 days per year or just slightly over 2% of the time.[16]

The stultifying effect on commerce of the port day formula is equally demonstrable. The basic function of the commerce clause of the Constitution of the United States is to place the control over interstate and foreign commerce in the hands of the Federal Government where it may remain free from barriers in the nature of tariffs around each state. This absence of tariff barriers is a necessary condition of truly free competition throughout the entire country to the end that activities may occur where they may be most efficiently pursued.

Thus, New York apple growers may compete with Washington apple growers for the California market and not suffer an economic disadvantage other than the natural disadvantage of having to ship their apples over a longer route. If factors of growth and production in New York

16 Furthermore, it is apparent that trivial variations in port time (a minor portion of the entire voyage) can have a major effect on taxation. For example, a single day's delay in California ports will, under port day allocation, change its allocation on that voyage from 1/2 to 2/3. A formula so unrelated to significant business factors can only be said to be "inherently arbitrary". Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 121, (1920); Norfolk & Western Ry. Co. v. North Carolina, 297 U.S. 682, 685 (1936).

are sufficiently more favorable than in Washington to make up for the greater cost of transportation, then the New York grower will be in a position to compete with the Washington grower in the California market.

Under the port day assumption, however, the New York grower will not be able to compete with the Washington grower even if the factors of growth and production in New York are so much more favorable than in Washington that they make up for the greater cost of transportation. For under the port day assumption as applied by California in this case, the California income tax for both the ship carrying apples from Washington and the ship carrying apples from New York is the same. But since the New York corporation's ships take approximately 10 times as long to reach California, they will have shipped approximately 1/10 as much per ship per year as will the ships of the Washington corporation. Therefore, *the tax cost per ton of apples shipped for the New York producer is almost 10 times that for the Washington producer.* Obviously, the California market is no longer equally available to both producers.

Voyage day allocation, advocated by appellant, does not so discriminate against the distant shipper. For under that method California would tax the New York corporation 1/10 as much per ship as the Washington corporation (port days *per voyage* in California are the same for each corporation but total port days in California during the year for the latter are ten times as great). However, each New York ship has shipped 1/10 as much goods per year as each Washington ship and hence the *tax cost per ton of goods shipped to California is the same in both cases.* The California market is thus still equally available to both producers, without any resulting discrimination.

That the tax under the port day assumption creates a tariff barrier around the State of California is evident. The tax cannot be based upon services or protection rendered by the State of California since the long haul shipper, using ships which are in the State of California 1/10 as long as the ships carrying the short haul shipper's goods, has his costs of shipment increased 10 times as much as those of the short haul shipper. The increase in the long haul shipper's costs is thus based upon the length of time which it takes the carrier to get from one state to another, i.e., it is a tax based in essence upon the crossing of a state line. If a state income tax upon an interstate carrier were based in part upon the number of times the carrier crossed the state line without reference to the time spent within the state, and was increased proportionately to the number of such crossings, the tax would be invalid as a tariff. In the instant case, the state line instead of being a mathematical line, having length but not breadth, is hundreds or thousands of miles wide, depending on the length of the sea voyage between the two states. The tax, as it bears upon the shipper, instead of being based upon the number of times the state line is crossed, is based upon the length of time it takes to cross the state line. The necessary effect of such a tax upon appellant, an instrumentality of interstate commerce, is to cause him to penalize the long haul shipper who has further to go to cross the state line, thus depriving him of his California markets in the same way as if a tariff based upon the number of miles of shipment between states had been imposed by the State of California.

The result of the California allocation formula as applied in this case is thus to create a tariff barrier around California with the result that the New York shipper can not any longer compete on equal terms with the Washing-

ton shipper for the California market. The tax burdens interstate commerce by making California markets less available to shippers in the more distant states. A tax which effects such a result clearly contravenes the commerce clause of the Constitution of the United States.

WHEREFORE, appellant respectfully submits that this Court has jurisdiction of this appeal under Section 1257 (2), Title 28, United States Code.

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(Appendices Follow)

Appendix A

Order Due Nov. 1, 1963

ORDER DENYING HEARING

After Judgment by District Court of Appeal
3rd District, Civ. No. 10519

IN THE SUPREME COURT OF
THE STATE OF CALIFORNIA
IN BANK

Luckenbach Steamship Company Incorporated,

v.

Franchise Tax Board

Traynor, J., did not participate.

Appellant's petition for hearing DENIED.

/s/ GIBSON

Chief Justice

Filed Oct. 23, 1963
William L. Sullivan, Clerk
By /s/ JMR.
S. F. Deputy

Appendix B

In the District Court of Appeal of the State of California in and for the Third Appellate District—[Sacramento]

3 Civ. 10519

Luckenbach Steamship Company, Inc., a corporation,
Plaintiff and Appellant,
vs.
Franchise Tax Board of the State of California,
Defendant and Respondent.

Filed: Sept. 3, 1963

California levies a tax on the net income of corporations engaged exclusively in interstate commerce.[1] Luckenbach Steamship Company, concededly subject to the tax, takes issue with the formula employed by the state Franchise Tax Board in allocating to California a portion of its net corporate income from interstate operations during the years 1942 through 1947.

Luckenbach is a Delaware corporation with its principal place of business in New York City. At the outbreak of

1. During the tax years in question, 1942 through 1947, the taxing statute was the Corporation Income Tax Act (Cal. Stats. 1937, ch. 765, as amended by Stats. 1939, ch. 1049), which has since been codified as sections 23501, et seq., Revenue and Taxation Code. The function of the California corporation income tax, as distinguished from the corporation franchise tax (Rev. & Tax. Code, secs. 23101, et seq.), was described in West Publishing Co. v. McColgan, 27 Cal. 2d 705. Cases sustaining state income taxation based upon an allocated portion of net income derived solely from interstate corporate business are summarized and collected in Portland Cement Co. v. Minnesota, 358 U.S. 450.

World War II it was operating a fleet of merchant vessels as a common carrier, principally in intercoastal trade, with stops at California ports. In 1942 wartime exigencies caused the federal government to requisition the ships of Luckenbach and other carriers and to place them under a "time charter" arrangement administered by the War Shipping Administration. Under this arrangement, which prevailed during most of 1942 and 1943, the government controlled the vessels' movements but Luckenbach continued as operator of the ships. Effective about the beginning of 1944 the government requisitioned the vessels on a "bareboat charter" basis under which the War Shipping Administration became the actual operator. Luckenbach retained legal title and acted as general agent for these and other government-operated vessels. During 1946, the vessels (other than several which were lost) were returned to Luckenbach, which resumed intercoastal common carrier operations.

Luckenbach filed California income tax returns for the years 1942 through 1947, utilizing a so-called "voyage-day" formula by which to compute that portion of its corporate income attributable, in its view, to California sources. Dissatisfied with the formula used by Luckenbach, the Franchise Tax Board levied an assessment for larger amounts, using the so-called "port-day" formula in the computation of income attributable to California. Luckenbach paid the additional taxes under protest and sued to recover. The trial court denied recovery and Luckenbach appeals. Sole issue on appeal is lawfulness of the port-day formula employed by the taxing agency as applied to income derived from operation of vessels during the years 1942 through 1947.

The problem is a perennial one in state taxation of multi-state business concerns. Where a firm's business operations

within and outside the taxing state are so closely integrated that each is dependent upon and contributes to the other, its income is treated as a unit, and it is regarded as a "unitary business" for state tax purposes. (Butler Bros. v. McColgan, 315 U.S. 501, affirming 17 Cal.2d 664; Bass, Ratcliff & Gretton, Ltd. v. State Tax Com., 266 U.S. 271; Pacific Fruit Express Co. v. McColgan, 67 Cal.App.2d 93.) Separate accounting of in-state activities of a unitary business does not accomplish clear segregation of net income attributable to sources within the taxing state. (John Deere Plow Co. v. Franchise Tax Bd., 38 Cal.2d 214, 223.) In order to allocate a part of the net income subject to state income taxation, the taxing state may apply a formula fairly calculated to reflect the relative contribution of in-state activities to total net income. (El Dorado Oil Works v. McColgan, 34 Cal.2d 731, 738; Edison California Stores v. McColgan, 30 Cal.2d 472, 479-480; Keesling and Warren, *The Unitary Concept in the Allocation of Income*, 12 Hastings L.J. 42; Altman and Keesling, *Allocation of Income in State Taxation* (2d ed. 1950) p. 107.) Various states have adopted varying formulae. (Hartman, *State Taxation of Corporate Income from a Multistate Business*, 13 Vand. L.Rev. 21, 65.)

California, like a number of other states, employs a three-factor formula consisting of property, payroll and revenue. A simplified statement of the formula is that the average of the percentages of property, payroll and revenue located or occurring in California is applied to unitary net income, in order to establish that portion attributable to California. Validity of the three-factor formula as an abstract proposition has been judicially confirmed and is not challenged here. (Butler Bros. v. McColgan, supra, 315 U.S. at p. 509; El Dorado Oil Works v. McColgan, supra, 34 Cal.2d at p. 738; Edison California Stores v. McColgan, supra, 30 Cal.

2d at p. 479.) What is challenged is the subordinate port-day formula used by the taxing agency as an adjunct of the property-payroll-revenue formula in computing Luckenbach's taxable income from ocean-going vessels. The ratio of the total days spent by a vessel in California ports during a given year to its total days spent in all ports was calculated. That ratio was applied to the vessel's value, payroll and revenue, as a preliminary to application of the standard three factor formula.[2] The port-day method is expressed fractionally as follows:

$$\frac{\text{Number of days in California ports}^{3}}{\text{Number of days in all ports}}$$

The voyage-day formula urged by Luckenbach apportions the vessel's income to California on the basis of ratio of the number of voyage days (including days in port) in California to the total number of voyage days during the period. Fractionally, this is expressed:

$$\frac{\text{Number of days in California}}{\text{Number of days in and out of California}}$$

2. The Franchise Tax Board points out that it has applied the port-day formula in a restricted manner and only as the vessels, their payrolls and revenue produced unitary income. For example, the port-day method was not applied to shoreside properties, shoreside payroll or bareboat charter revenue. Flexible administration of apportionment formulae to meet individual situations is discussed and sanctioned in El Dorado Oil Works v. McColgan, supra, 34 Cal. 2d at pp. 735-736. See Rev. & Tax. Code sec. 25101.

3. The port-day formula is discussed in Altman and Keesling, op. cit. supra, p. 120, and in Wahrhaftig, *Allocation Factors in Use in California*, 12 Hastings L.J. 65, 81-82. In 1957 Revenue and Taxation Code section 25101 was amended, and it is said that this amendment eliminated the port-day formula and substituted the voyage-day formula as a statutory mandate. (See 18 Cal. Admin. Code, Reg. 25101; Wahrhaftig, op. cit. supra, p. 82.) At the same time section 25101.1 was added, declaring that the Legislature was legislating for the future and intended no inference as to preceding tax years.

Thus, in the case of a ship which occupied 10 per cent of its time in California ports, 30 per cent in other ports and 60 per cent on the high seas, the California allocation of property-payroll-revenue would be one-quarter under the port-day formula but only 10 per cent under the voyage-day method.

Luckenbach points out that vessels earn income not only in ports but while traveling the high seas, outside the territorial limits of California or any other taxing jurisdiction; that a fair apportionment formula would allocate some portion of vessel income to the location (high seas) where it is earned; that the port-day formula refuses recognition to vessel time on the high seas, results in extra territorial-taxation of income earned on the high seas and violates the due process and interstate commerce provisions of the federal Constitution, as well as the then current provisions of the taxing law itself. The argument emphasizes location of the income-producing activity as the dominant element in apportioning unitary income. (See Hartman, op. cit. supra, 13 Vand.L.Rev. at pp. 663-665.)

The courts have had numerous occasions to consider local ad valorem taxability of vessels plying the high seas in interstate and foreign commerce. (See cases cited in Scandinavian Airlines System, Inc. v. County of Los Angeles, 56 Cal.2d 11, 21-24, 45.) So far as we are aware, this is the first case considering apportionment of unitary income derived exclusively from ocean-going vessels.

The due process phase of the taxpayer's attack rests on the general principle that states may not tax income of foreign corporations derived from extraterritorial sources. (Connecticut General L. Ins. Co. v. Johnson, 303 U.S. 77; James v. Dravo Contracting Co., 302 U.S. 134; Hans Rees'

Sons, Inc. v. No. Carolina ex rel. Maxwell, 283 U.S. 123.) The limit of taxability has been described in various ways. In assessing taxes against interstate income, the state may not tax "extraterritorial values." (Butler Bros. v. McColgan, supra, 315 U.S. at p. 507.) Its taxing power must bear "fiscal relation to protection, opportunities and benefits given by the state"; a controlling question is "whether the state has given anything for which it can ask return." (Wisconsin v. J. C. Penney Co., 311 U.S. 435, 444.) A formula for apportionment of unitary income must be "fairly calculated" to assign to the taxing state that portion of income "reasonably attributable" to the business done there. (Butler Bros. v. McColgan, supra, 315 U.S. at p. 506; Bass, Ratcliff & Gretton, Ltd. v. State Tax Com., supra, 266 U.S. at pp. 281-282; Southern Pacific Co. v. McColgan, 68 Cal. App.2d 48, 60.) A formula valid in its general application must pass the test of fairness as applied to the individual taxpayer's situation. (Norfolk & Western Ry. Co. v. North Carolina, 297 U.S. 682, 685; Pacific Fruit Express Co. v. McColgan, supra, 67 Cal.App.2d at pp. 99-100.) If the formula attributes to the taxing state income "out of all appropriate proportion" to the business done there, the formula and the tax will fall. (Hans Rees' Sons v. North Carolina ex rel. Maxwell, supra, 283 U.S. at p. 135.) One who attacks a formula of apportionment carries a "distinct burden" of showing by "clear and cogent evidence" that extraterritorial values are being taxed. (Butler Bros. v. McColgan, supra, 315 U.S. at p. 507; Norfolk & Western Ry. Co. v. North Carolina, supra, 297 U.S. at p. 688; El Dorado Oil Works v. McColgan, supra, 34 Cal.2d at p. 744.)

It is impossible to divide the revenues and costs of a unitary business in accordance with state lines. (Norfolk

& Western Ry. Co. v. North Carolina, supra, 297 U.S. at p. 684; Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 121.) Recognizing the artificiality of formulary devices, the courts have demonstrated a readiness to sustain any formula reasonably designed to determine the net income attributable to business done in the taxing state. (Portland Cement Co. v. Minn., supra, 358 U.S. at p. 460; International Harvester Co. v. Evatt, 329 U.S. 416, 422-423; Butler Bros. v. McColgan, supra, 315 U.S. as pp. 506-507; El Dorado Iron Works v. McColgan, supra, 34 Cal.2d at pp. 744-745; John Deere Plow Co. v. Franchise Tax Bd., supra, 38 Cal.2d at pp. 224-225; Hartman, op. cit. supra, 13 Vand. L.Rev. at p. 67.) Precision is not required, but only "rough approximation." (International Harvester Co. v. Evatt, supra, 329 U.S. at p. 422; El Dorado Oil Works v. McColgan, supra, 34 Cal.2d at p. 741.)

The techniques of income apportionment, in all their unavoidable complexity, represent a search for meaningful measurements by which to gauge the portion of integrated income-producing activity attributable to a particular taxing jurisdiction. If the business activity is relatively immobile, location or space is the principal dimension to be measured. Some businesses, particularly the transportation industry, have strong migratory as well as stationary aspects. Thus the element of time becomes a logically acceptable dimension, available for measurement. A third dimension, which we might call the "production element," is present. Activity occurring at a particular location and within a particular time span may have been produced by activity at a different place and earlier time; and it might produce no profit at all except for the fact that it will result in further activity at a third location during

a third time span. The production element thus transcends time-space. Economic activity in the transportation industry moves in all three of these dimensions.

Allocation formulae devised for specialized use in the taxation of interstate transportation commonly take account of one or more of these dimensions. (See Braniff Airways v. Nebraska State Board, 347 U.S. 590; Ott v. Mississippi Valley Barge Lines Co., 336 U.S. 169; Central Greyhound Lines v. Mealey, 334 U.S. 653; Norfolk & Western Ry. Co. v. North Carolina, supra, 297 U.S. 682; Flying Tiger Line, Inc. v. County of L.A., 51 Cal.2d 314; Slick Airways v. County of Los Angeles, 140 Cal.App.2d 311; Pacific Fruit Express Co. v. McColgan, supra, 67 Cal.App.2d 93; Altman and Keesling, op. cit. supra, pp. 117-118.) But insistence on measurement of one or two of these dimensions to the exclusion of the remainder rests on a distortion. We must not adopt the attitude of the blind man who seized the elephant's tail and compared the animal to a rope. It is enough that the formula rest on one or a combination of logically relevant factors. Evidence directed at one of several related factors falls short of demonstrating that the formula is arbitrary or produces an unreasonable result; it "must be directed to each of them alike, for only thus can the assumed relation between them be proved to be unreal." (Norfolk & Western Ry. Co. v. North Carolina, supra, 297 U.S. at p. 688; Butler Bros. v. McColgan, supra, 17 Cal.2d at p. 677.)

The notion that an interstate vessel earns income on the high seas, outside any taxing jurisdiction and hence immune from taxation, accepts the time-space dimensions but ignores the "production" dimension: Were it not for the productive potential acquired at the port of departure

and liquidated at the port of destination, the high seas portion of the time-space continuum would be barren of profit. The obverse is just as true. The embarkation of payload within one taxing jurisdiction and its discharge within another would be impossible without the connecting voyage over the tax-free face of the deep. The port-day formula acknowledges the productive values supplied to the entire voyage, including the high seas sector, by activities within California.

Both these formulae, voyage-day and port-day, employ the time factor as a qualification upon the spatial elements implicit in the property-payroll-revenue formula. They part company over the production element. The voyage-day method excludes the production element as an extension of shorebased activity accompanying the vessel on the high seas. In insisting upon recognition of California-produced values which contribute to the total value of the entire voyage, the port-day formula is consistent with due process concepts. The very notion of a unitary business implies that the taxpayer's affairs within and outside the taxing jurisdiction are so indivisable that income from property and activities within the jurisdiction cannot be measured without taking into account income from property and activities located elsewhere. (Butler Bros. v. McColgan, supra, 17 Cal.2d at p. 668; John Deere Plow Co. v. Franchise Tax Board, supra, 38 Cal. 2d at p. 223. Keesling and Warren, op. cit. supra, 12 Hastings L.J. at p. 46.) The business is not divisible by state lines. It must be treated as a unit even though part of it is in another state or travels on the high seas. In measuring what portion of the sum total is fairly attributable to the taxing state, the latter must necessarily take into account income

which, in a sense, has been "earned" outside its borders. There is nothing unconstitutional about this. The only question is whether the state's method is proportional to the "protection, opportunities and benefits" which it has conferred. (Wisconsin v. J. C. Penney Co., supra, 311 U.S. at p. 444.) Due process does not prohibit a formula which considers out-of-state activity in evaluating the local activity. (International Harvester Co. v. Evatt, supra, 329 U.S. at pp. 420-421; Hartman, op. cit. supra, 13 Vand.L.Rev. at p. 114.) An argument that the state confers no protection, no opportunities or benefits on the high seas, ignores an imponderable part of the ship's cargo, the values created at the port of embarkation and port of debarkation. In molding its apportionment formula to embrace productive values supplied at California ports to the entire voyage, the state is taxing not extraterritorial values, but values "reasonably attributable" to activity within California.[4]

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4. We do not mean to devalue the factor of location. It may be important or unimportant, according to the characteristics of the particular business enterprise. In Butler Bros. v. McColgan, supra, and in Bass, Ratcliff & Gretton, Ltd. v. State Tax Com., supra, the state was able to tax an allocated portion of the company's unitary profits even though the company had lost money on its in-state operations. In John Deere Plow Co. v. Franchise Tax Board, supra, 38 Cal. 2d at pp. 226-227, the court states: "With regard to a unitary business, the place where expenses affecting the entire business are incurred has little or no bearing on the question of how such expenses should be allocated." On the other hand, in El Dorado Oil Works v. McColgan, supra, the court sustained a formula which assigned 100 per cent of sales, including interstate sales, to California, since the taxpayer had no sales facilities outside this state, saying (34 Cal. 2d at p. 742): "Accordingly, the focal point for consideration is the place where the activities of the corporation occurred which resulted in the sales." In Wisconsin v. J. C. Penney Co., supra, the very event upon which the apportioned tax was levied, a declaration of corporate dividends, took place outside the taxing state, and this fact generated the following statement (311 U.S. at p. 445): "The

Having concluded that the port-day formula is reasonably proportioned to California-contributed values and hence consistent with due proces, we turn to the interstate commerce argument. Corporations engaged exclusively in interstate commerce are subject to a net income tax on a portion of their net income reasonably attributable to the taxing state. (Portland Cement Co. v. Minn., supra, 358 U.S. 450; West Publishing Co. v. McColgan, 328 U.S. 823, affirming 27 Cal.2d 705; Memphis Natural Gas Co. v. Beeler, 315 U.S. 649; Norfolk & Western Ry. Co. v. North Carolina, supra, 297 U.S. 682; Hartman, op. cit. supra, 13 Vand.L.Rev. at p. 64.) The states, however, may not discriminate against interstate commerce by subjecting it to cumulative tax burdens to which local commerce is not exposed. If state taxation imposes on interstate commerce multiple taxes or the risk of multiple taxation, it is discriminatory and must fall. (Gwin, White & Prince v. Henneford, 305 U.S. 434, 439; J. D. Adams Mfg. Co. v. Storen, 304 U.S. 307, 311.)

Gist of the interstate commerce objection is the risk of multiple state taxation upon the ocean voyage through sanctioning use of high seas time as an element in apportionment formulae which might be used by several states. An apportioned tax, measured by the values created in the taxing state, eliminates in a practical sense the danger of multiple tax burdens. (Portland Cement Co. v. Minn., supra, 358 U.S. at pp. 462-463; Standard Oil Co. v. Peck, 342 U.S. 382, 384; see Schwartz, *The Supreme Court*, p. 215-217.) True, there is a theoretical possibility that divergent formulae or varying definitions in administration of seemingly identical

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fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction." Thus, in the formula taxation of unitary interstate income, physical location signals neither tax immunity nor subjection.

formulae may create cumulative tax burdens. The taxpayer, however, has not demonstrated any tangible possibility that more than 100 per cent of its unitary income will be taxed. "There is nothing to show that multiple taxation is present. We cannot deal in abstractions. In this type of case the taxpayers must show that the formula places a burden upon interstate commerce in a constitutional sense. This they have failed to do." (Portland Cement Co. v. Minn., supra, 358 U.S. at p. 463.)

Lastly, we reach the objection that by allocating to California a portion of vessel property-payroll-revenue occupied by the high seas voyage, the port-day formula violated statutory language limiting the tax to income "derived from sources within" and resulting from "activities carried on in" this state.[5] Such an interpretation limits ambit of the statute more narrowly than constitutional lines, at least as we view the latter. The statute, on the contrary, is coextensive with the state's constitutional power to tax. (Butler Bros. v.

5. During the tax years in question the applicable sections of the Corporation Income Tax Act (Cal. Stats. 1937, ch. 765, as amended by Stats. 1939, ch. 1049) read as follows:

"Sec. 3. There shall be levied, collected and paid for each taxable year, a tax . . . upon the net income of every corporation derived from sources within this state. . . . Income from sources within this State includes income from tangible or intangible property located or having a situs in this State and income from any activities carried on in this State, regardless of whether carried on in intrastate, interstate or foreign commerce."

"Sec. 13. In the case of corporations owning property or engaging in business or activities both within and without the State, the net income derived from sources within this State shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property or by reference to any of these or other factors or by such other method of allocation as is fairly calculated to determine the net income from sources within this State. Income from business carried on partly within and partly without this State shall be allocated in such manner as is fairly calculated to apportion such income among the States or countries in which such business is conducted.

McColgan, supra, 17 Cal. 2d at p. 677; see also Matson Navigation Co. v. State Bd. of Equalization, 3 Cal.2d 1, 8.)

In 1939 section 13 of the Corporation Income Tax Act was amended by addition of the following sentence: "Income from business carried on partly within and partly without this State shall be allocated in such manner as is fairly calculated to apportion such income among the States or countries in which such business is conducted." It has been said that the amendment was designed to sanction the port-day formula by preventing steamship income from being attributed to the high seas. (Altman and Keesling, op. cit. supra, pp. 119-120.) We have no usable interpretive aids pointing to that statutory purpose. The precise language is subject to the somewhat metaphysical objection that business conducted on the high seas cannot be divided up between the states or countries in which it is conducted because it is not conducted within states or countries. Aside from conflicting possibilities suggested by fine-spun exegesis, the amendment's essential objective is fairly apparent, that is, to allow division of all and not part of income for tax purposes among the various jurisdictions which had power to tax it. It was not designed to deprive the taxing agency of the very flexibility in apportionment delegated to it by the preceding part of the same section. (See El Dorado Oil Works v. McColgan, supra, 34 Cal.2d at p. 736.) The port-day formula is consistent with the amendment's objective.

Judgment affirmed.

FRIEDMAN J.

We concur:

SCHOTTKY J.

JANES J. pro tem.

Appendix C

In the Superior Court of the State of California
In and for the County of Sacramento

No. 93371

Luckenbach Steamship Company, Inc., a corporation,
Plaintiff,

vs.

Franchise Tax Board of the State of California,
Defendant.

Filed OCT 17 1960

OPINION ON ISSUES OF:

(1) CAPITAL GAINS;

(2) BAREBOAT CHARTER REQUISITIONING;

(3) THE PORT DAY; and,

(4) REIMBURSABLE WAGES

After oral argument, the issues stated in the above caption were referred to the Court for determination after which a stipulation is to be drawn and further argument presented concerning further issues not presently before me with sufficient explanation to permit final determination.

Following oral argument and (I believe) aided thereby, I have re-examined and restudied the briefs and have read and attempted to digest the Stipulation of Facts on file, and I have reached the conclusions stated below.

Issues to Be Decided

The questions at issue involve the validity of a deficiency assessment by the California Franchise Tax Board of corporation income taxes against the plaintiff Luckenbach Steamship Company during the years 1942 through 1947. Plaintiff seeks a refund of certain of those taxes paid (under protest) with interest. It challenges the Franchise Tax Board's determination of what constitutes plaintiff's "unitary" income subject to allocation and the proportion of such income allocated to California. More specifically, this challenge centers upon (1) the treatment by California of income consisting of capital gains from loss or sale of vessels as income of the unitary business; (2) California's inclusion as taxable income of "just compensation" paid by the United States for use of plaintiff's vessels requisitioned under the "Bareboat Charter" method; (3) Use of the "Port-Day" theory in applying the "Three Factor" Formula to determine California's share of unitary income; and (4) Inclusion by California in the wage factor of the "Three Factor" formula of reimbursed wages under Federal contracts relating to plaintiff's stevedoring and terminal business. A fifth question concerning depreciation has been removed from the case and other correlated questions are awaiting determination of the questions above. The questions above stated will be discussed seriatim and meaning of the technical terms stated above will (it is hoped) be clarified in the discussion below.

* * * * * * *

The Port Day Issue

In the three-factor formula used by the State during all of the years involved in the complaint, defendant treated

as California property that portion of the value of plaintiff's vessels and other floating properties which the number of days in each year the vessels spent in California ports bore to the number of days in each year the vessels spent in all ports of the world. This is known as the "port day" formula. It utilized the same formula in allocating wages and in allocating those revenues during the time charter requisition period.

The State claims that the port day formula was clearly contemplated by statute as the law was in 1942-1947:

> "Income from business carried on partly within and partly without this State shall be allocated in such manner as is fairly calculated to apportion such income among the States or countries in which such business is conducted (Sec. 13 Corporation Income Tax Act)."

According to Altman and Keesling (p. 119), the specific purpose of this sentence in the law was "to insure that a portion of the income of steamship companies would not be attributed to the high seas." This seems to be reasonably inferable from the language quoted above.

But the question remains: So construed, is the provision constitutional?

Of course, the mere fact that some portion of allocable income escapes taxation as, for example, where another State or country wherein a portion of annual income is earned does not levy a tax will not justify California or any other State in "appropriating" a larger percentage of the aggregate. The reason for this restriction is that taxes assessed must be based upon benefits provided the taxpayer by the taxing jurisdiction and where taxes are to be allo-

cated the percentage of allocation must bear a relation to the benefits conferred (*Southern Pac. Co. v. McColgan*, (1945) 68 C.A. 2d 49; *Wisconsin v. J. C. Penney Co.*, (1940) 311 U.S. 435).

Plaintiff takes the position that the same considerations apply where a portion of the revenue is earned and a portion of wages paid while the property which produces the income is in a geographical area having no taxing jurisdiction at all, e.g., while on the high seas. It urges, therefore, the unconstitutionality of any allocation method other than what is known as the "voyage day" formula which treats as California property, payroll and revenue the portion thereof only which the number of days the vessels spend in California bears to the number of days the vessels spend in and out of California. Under this formula, of course, similarly applied to all other taxing jurisdictions the time spent on the high seas would be tax free time.

The shipping industry was able to "sell" this theory to the California legislature in 1957, and the Uniform State Laws Commissioners in 1957 adopted the voyage day formula as a part of a Model Code.

But the fact that the voyage day formula has been found desirable does not necessarily mean that the port day formula which seems clearly contemplated by the California statute as it was before 1957, is unconstitutional.

Defendant says that the port day formula is fair and equitable; that it does not result in taxing in California more than that percentage of the total unitary income which is correlative to benefits conferred upon the taxpayer in California. If that is true, then constitutional prohibitions are not violated. Altman and Keesling have stated that, as related to the property factor (and no distinction would

seem logically drawn separating that factor from wages and revenue), "the port-day formula is a far more satisfactory and fairer rule . . ." (p. 119).

Plaintiff denies defendant's claim that "income does not have its source on the high seas." But the Court feels that this is true. Steamship companies derive their income from passengers and cargo and they do not pick them up or discharge them on the high seas (in the absence of casualty, at least). The governmental benefits which must be correlated to the taxing power are conferred at points of departure, ports of call, points of destination. Plaintiff sees the port day formula as penalizing the long haul carrier defendant sees the voyage day formula as discriminating in favor of the long haul carrier while penalizing the short haul carrier. That is the way the Court sees it.

Both parties here have referred to *Flying Tiger Line, Inc. v. County of L.A.*, (1958) 51 C.2d 314, where the County levied a property tax on 100% of the assessed value of five DC-4 planes owned by plaintiff and used on the "Pacific air lift" during the Korean War. The California Supreme Court held this improper, pointing out that although in *Northwest Airlines, Inc. v. Minnesota*, (1944) 322 U.S. 292, the Supreme Court had held that the home port state of an airline could levy a property tax on the entire value of a fleet of airlines in spite of the fact that other states through which they operated taxed a portion of their value, this rule had been modified and that (applicable to airlines) the Supreme Court in *Braniff Airways, Inc. v. Nebraska Board, etc.*, (1954) 347 U.S. 590, had upheld an apportionment of an ad valorem tax "based upon the percentage of time in and out of the (taxing) state."

The Court also referred to *Slick Airways, Inc. v. County of L.A.*, 140 C.A. 2d 311, and quoted from the decision therein which stated that an assessment based upon "the ratio of time spent in Los Angeles County as compared to total time" was proper.

The *Flying Tiger* case does not settle the port-day issue, but the Nebraska statute involved in the *Braniff* case based its allocation on scheduled and non-scheduled points of arrival and departure which is analogous to the port-day principle.

Notwithstanding dicta on the concurring opinion of Justice Carter in the *Flying Tiger* case, no court has held to our knowledge that the several taxing jurisdictions which afford terminal benefits or benefits while the planes, trucks or vessels (whether river boats or ships that sail the seas) of a taxpayer in the transportation business pass through or fly over its territory cannot tax during the period that its rolling stock is passing through a geographical area having no taxing jurisdiction. It is my opinion that collectively the states, territories, possessions, and countries do confer benefits justifying taxation to carriers operating on the high seas, furnishing them with the passengers and cargo for carriage between the several jurisdictions having taxing powers.

It is, therefore, held that California corporate income taxation during this period on the basis of the port-day formula is valid.

* * * * * * *

Appendix D

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In the Superior Court of the State of California
In and for the County of Sacramento

Luckenbach Steamship Company, Inc., a corporation,
Plaintiff,
vs.
Franchise Tax Board of the State of California,
Defendant.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on regularly for trial before the Court sitting without a jury, the Honorable Fred R. Pierce, Judge presiding, Dorr, Cooper & Hays, by George L. Waddell, appearing for plaintiff, and Stanley Mosk, Attorney General of the State of California, by Ernest P. Goodman and John M. Traynor, Deputy Attorneys General, appearing for defendant. A stipulation of facts,

together with a number of supplementary stipulations of facts, all of which were signed by the respective parties, were filed and received by the Court, and defendant's answer having been amended to conform to proof presented at the trial, and the cause having been thereafter submitted subsequent to the filing of written briefs and the presentation of oral argument, the Court having considered the evidence and being fully advised in the premises, and having rendered its decision herein, now makes its findings of fact and conclusions of law as follows:

Findings of Fact

I

The Court finds that the facts are as stated in the Stipulation of Facts and in the following additional stipulations:

(1) Supplementary stipulation of Facts (respecting vessels which were title requisitioned);
(2) Second Supplementary Stipulation of Facts;
(3) Stipulation re Gain on Title Requisitioning of Vessels;
(4) Supplementary Stipulation of Facts (respecting depreciation deduction);
(5) Stipulation re 1946 Returns;
(6) Stipulation re Computation of Judgment.

The Court adopts all of said stipulations as its Findings of Fact in this matter.

II

The Court further finds that each and every allegation of the complaint which is not included in the above referred to stipulations of facts on file herein, or either admitted

by the answer as amended, or expressly found to be true in these findings, is untrue.

Conclusions of Law

As conclusions of law from the foregoing findings of fact, the Court concludes as follows:

I

The assessments of franchise tax for the years 1942, 1943, 1944, 1945, 1946 and 1947 here in controversy were properly, duly and regularly made and imposed in accordance with the provisions of the Bank and Corporation Franchise Tax Act and were valid in all particulars with the exceptions noted below:

A. With respect to the bareboat charter hire issue:

(1) The income from bareboat charter hire of plaintiff's vessels was improperly included as part of plaintiff's unitary income for the years 1944, 1945 and 1946;

(2) The revenue from the bareboat charter hire of plaintiff's vessels was improperly included as part of the revenue factor for the years 1944, 1945 and 1946;

(3) The value of the vessels utilized in the bareboat hire operations was improperly included as part of the property factor for the years 1944, 1945 and 1946.

B. The Franchise Tax Board for the year 1947 improperly disallowed the depreciation deduction on plaintiff's newly acquired vessels, the Edgar Luckenbach, Andrea Luckenbach, Mary Luckenbach and Julia Luckenbach, and improperly reduced the value of such vessels in the property tax factor of the allocation formula.

C. Defendant is entitled to an offset against refunds otherwise payable of the underpayment of plaintiff's tax

for the year 1946 resulting from the fact that the capital gain plaintiff realized on the title requisitioning of the Lena Luckenbach, the Lewis Luckenbach, and the Dorothy Luckenbach was never included in plaintiff's net income for the year 1946, or used in the computation of its tax for 1946.

II

The adjustments which are required in the allocation formula and the tax payable by plaintiff for each of the years as to which a change is required by virtue of the legal conclusions set forth in finding I above are as set forth in Schedule A to the Stipulation re Computation of Judgment on file herein.

III

By virtue of the foregoing legal conclusions as to the issues here presented, the plaintiff is entitled to a refund in the sum of $16,129.94 computed as set forth in schedules A and B to the Stipulation re Computation of Judgment on file herein, together with additional interest on the sum of $10,180.70 from June 15, 1961 at the rate of one-half of one per cent per month or fraction thereof, together with plaintiff's costs of suit herein.

Dated:

/s/ FRED R. PIERCE
Judge of the Superior Court

Appendix E

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In and for the County of Sacramento

No. 93371

Luckenbach Steamship Company, Inc., a corporation,
Plaintiff,

vs.

Franchise Tax Board of the State of California,
Defendant.

JUDGMENT

This cause came on regularly for trial before the above entitled Court sitting without a jury, the Honorable Fred R. Pierce, Judge presiding, Dorr, Cooper & Hays, by George L. Waddell, appearing for plaintiff, and Stanley Mosk, Attorney General of the State of California, by Ernest P. Goodman and John M. Traynor, Deputy Attorneys General,

appearing for defendant. A stipulation of facts, together with a number of supplementary stipulations of facts, all of which were signed by the respective parties, were filed and received by the Court, and defendant's answer having been amended to conform to proof presented at the trial, and the cause having been thereafter submitted subsequent to the filing of written briefs and the hearing of oral argument, the Court having made and filed its findings of fact and conclusions of law herein and ordered that judgment be entered for plaintiff in accordance therewith,

Now, Therefore, It Is Hereby Ordered, Adjudged and Decreed that plaintiff have judgment in the sum of $16,129.94, together with additional interest on the sum of $10,180.70 from June 15, 1961 at the rate of one-half of one per cent per month or fraction thereof, together with plaintiff's costs of suit herein in the sum of $.....

Dated: Sep 25, 1961.

/s/ Fred R. Pierce
Judge of the Superior Court

Office-Supreme Court, U.S.
FILED
APR 10 1964
JOHN F. DAVIS, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 916

LUCKENBACH STEAMSHIP COMPANY, INC., a corporation,
Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

On Appeal from the District Court of Appeal, Third Judicial District, State of California

Motion to Dismiss or Affirm

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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 916

LUCKENBACH STEAMSHIP COMPANY, INC., a corporation,
Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

On Appeal from the District Court of Appeal, Third Judicial District, State of California

Motion to Dismiss or Affirm

Appellee, pursuant to Rule 16 of the Revised Rules of the Supreme Court of the United States, hereby moves the Court to dismiss this appeal or to affirm the judgment of the California District Court of Appeal, for the following reason:

There is no substantial federal question presented as a basis of jurisdiction in this Court.

QUESTION PRESENTED

This is an action for refund of state income tax brought by appellant, a steamship company engaged in business

in California as well as other states and countries and which during the period here in controversy maintained a permanent office and place of business in California.[1] A portion of appellant's income is "unitary" in nature, and the portion thereof taxable by California must be determined by use of an allocation formula. The California Corporation Income Tax Law provisions in effect during the years here involved required the Franchise Tax Board to apply an apportionment formula to the unitary income of a steamship company, such as appellant, which would apportion that income between the various states and countries in which that company did business. It is undisputed that the formula used by appellee complied with that legislative mandate. Thus, under appellee's method, a steamship company engaged in transporting property between San Francisco, California, and Portland, Oregon, would have its unitary income apportioned between California and Oregon so as to appropriately reflect the relative activities in the two states. It is the position of appellee that such an allocation formula is clearly constitutional and that, accordingly, this appeal does not present a substantial federal question.

Appellant does not argue that the formula used by appellee does not reach such a fair apportionment of its unitary income. To the contrary, appellant's attack on the method of apportionment used by appellee is based on the assertion that any method of apportionment which does not operate so as to allocate a portion of a steamship company's income to the "high seas" and thereby exempt that income

---

1. The taxable years involved are 1942-1947. The amount involved is less than $22,000. Appellant's total unitary income subject to formula apportionment for the years 1942-1947 was approximately $21,000,000.00.

from taxation by *any* state or country is invalid.[2] In other words, with regard to the foregoing example of a steamship company operating between San Francisco, California, and Portland, Oregon, appellant asserts the method of apportionment used by appellee violates the U.S. Constitution because it does not allocate a portion of the company's income to the "high seas" and thereby exempt that income from taxation by either California or Oregon. We submit that appellant's contention in that regard is unmeritorious and note that appellant has failed to cite a single decision of this Court or any other Court which recognizes a "no man's land" to which a portion of the unitary income of a business must be allocated so as to exempt that income from taxation.[3]

It is to be noted that the question here presented is no longer a matter of administrative concern since in 1957 the shipping industry was successful in getting the California statutory plan amended so as to require statutorily what appellant here argues is required constitutionally. (Cal. Stats. 1957, Ch. 2097, § 1, p. 3721)

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2. We are not here concerned with the power of the State of legal and/or commercial domicile to impose a tax. While the State of domicile might perhaps tax 100% of the income of a corporation without regard to where or from what source derived, the States, in order to encourage local business and avoid discrimination against domestic corporations, do not attempt to exercise their full taxing powers, but apply allocation concepts to both foreign and domestic corporations alike. For example, in the present case, California would have applied the same allocation formula and would have allocated the same portion of appellant's unitary income to California even if appellant had been both legally and commercially domiciled in California.

3. The issue, as just set forth, is clear, and it is readily apparent that the statements of appellant concerning the issue involved and concerning appellee's contentions are misleading and erroneous. We do not contend that appellant's vessels were always in a port and never on the ocean. Nor do we contend that California can tax "extraterritorial income" within the meaning of established decisions of this Court. Appellant's statements in this regard merely tend to obscure the otherwise clear issue presented by this appeal.

STATEMENT OF THE CASE

This case was tried on the basis of stipulated facts, the relevant portions of which are summarized below:

Appellant, Luckenbach Steamship Company, is a corporation which was incorporated under the laws of Delaware in 1913 and had its principal place of business in New York. Throughout the period here involved, appellant conducted business, utilized employees, maintained offices, and had approximately one-third of its shoreside employees permanently stationed in California.

Prior to 1942, appellant was engaged in the business of operating a fleet of merchant vessels as a common carrier, chiefly in the United States intercoastal service. In such operations, appellant's vessels made stops at California ports as well as other ports on the Pacific Coast, the Atlantic Coast, and elsewhere. In connection with its shipping operations, it also performed stevedoring and terminal operations for its vessels in certain ports.

In April of 1942 the United States Government requisitioned all of appellant's vessels (twenty-two in number) on a time charter basis for use by the War Shipping Administration. In 1944 the vessels were requisitioned on a bareboat charter basis. Most of appellant's vessels were returned to it at various times in 1946.

Subsequent to redelivery of the vessels in 1946 and throughout the year 1947, appellant was engaged in the business of operating as a common carrier a fleet of merchant vessels, chiefly in the intercoastal trades. In such operations appellant's vessels made stops at ports in California as well as other ports on the Pacific Coast, the Atlantic Coast, and elsewhere.

During the years when its ships were under time or bareboat charter to the federal government, appellant acted as

a general agent for the United States Government with respect to a maximum of 82 vessels including its own. During this same period, appellant performed stevedoring and terminal services under contracts with the Government. The appellant also operated stevedoring and terminal facilities after its vessels were returned to it in 1946.

In the assessments for all the years involved in this action, appellee used an allocation formula consisting of the three factors of property, wages and revenue in order to compute the portion of appellant's unitary net income taxable by California. Due to the fact that appellant's vessels did not remain in any particular state during the year, that portion of appellant's property could not be assigned solely to one particular state for purposes of the apportionment formula. Therefore, in computing the property factor of the formula, appellee included in the numerator of the fraction, together with the value of all property permanently situated in California, that portion of the value of appellant's vessels which the number of days in each year the vessels spent in California ports bore to the number of days in each year the vessels spent in all ports of the world.[4] This method of determining vessel properties attributable to California for use in the allocation formula may be expressed as follows:

$$\frac{\text{Number of days vessel spent in California ports}}{\text{Number of days vessel spent in all ports of world}}$$

and is hereinafter referred to as the "port day" formula.

In computing the wage factor of the allocation formula, appellee also utilized the "port day" formula in order to

4. Of course, only property used to produce unitary income is included in the formula. Therefore, since bareboat charter revenues do not constitute unitary income, vessel properties were not included in the property factor when, such as in 1945, appellant's only vessel operations were under bareboat charters.

determine the portion of the wages paid by appellant to personnel of appellant's vessels attributable to California. Wages of personnel on vessels under bareboat charter were not paid by appellant and were not included in computing the wage factor. Wages paid shoreside personnel were assigned to the state in which the individual employee worked and were not subject to the "port day" formula.

In computing the revenue factor of the allocation formula, appellee also utilized the "port day" formula in order to determine the portion attributable to California of revenues received by appellant as compensation for use of vessels requisitioned on a time charter basis and also with respect to general agency revenues. Since revenues from vessels under bareboat requisition are excluded from unitary income subject to apportionment, those revenues do not appear in the revenue factor. Revenues resulting from regular commercial operations of appellant's vessels were treated in a different manner, the propriety of which is not in issue in this litigation.

In appellant's protests and claims for refund for all of said years appellant's income taxable by California was likewise computed by an apportionment formula using the factors of property, wages and revenues. However, in each instance wherein appellee applied the "port day" formula in order to determine the portion of vessel values, vessel personnel wages, and time charter and general agency revenues attributable to California, appellant treated as California property, California wages, and California revenues that portion of the value of the vessels, the wages paid to personnel on said vessels, and time charter and general agency revenues which the number of days in each year the vessels involved spent in California bore to the number of days in each year the vessels spent in and out of California. This

method of determining vessel values, vessel personnel wages, and time charter and general agency revenues attributable to California for use in the allocation formula may be expressed as follows:

$$\frac{\text{Number of days vessels spent in California}}{\text{Number of days vessel spent in and out of California}}$$

and is hereinafter referred to as the "voyage day" formula.

The only question raised by this appeal is whether the use by respondent of the "port day" formula in the instances described above was proper. Before demonstrating that the formula used by appellee is fair and violates no constitutional limitations on State taxation it is necessary to correct the assumption made throughout appellant's Jurisdictional Statement to the effect that the "port day" formula percentage is the percentage of appellant's unitary income that was taxed by California. That assumption is factually incorrect. A single day's delay in port would not, as appellant asserts, change the allocation percentage from $^1/_2$ to $^2/_3$.

The "port day" formula, when used with regard to the property factor, only applies to vessels. Property permanently located in a particular state is always assigned to that state for formula purposes. Moreover, it only applies to property used to produce unitary income subject to apportionment.

With regard to the payroll factor, the "port day" formula is only applied to wages paid vessel personnel. The wages paid to the substantial number of shoreside personnel of appellant were in all cases assigned to the particular state or country in which the personnel worked. Since appellant had no vessel personnel in 1945, the "port day" formula was not used at all with regard to the wage factor for that year.

The "port day" formula was not used with regard to the revenue factor of the formula as far as ordinary operating

revenues were concerned. The "port day" formula also had no relation to bareboat charter revenues since they did not constitute unitary income and were not, therefore, included in the revenue factor. The only vessel operation revenues which were affected by the "port day" formula were time charter revenues. In addition, revenues from appellant's activities as general agent for the federal government were included in the revenue factor on a "port day" basis. Since appellant had no time charter operations in 1945, the "port day" formula was not used with regard to any vessel operation revenues for that year.

In every case these shoreside properties, wages, and revenues were substantial, not nonexistent as appellant's Jurisdictional Statement would lead the reader to believe. Accordingly, application of either the "port day" formula or the "voyage day" formula to vessel properties, seamen's wages, and time charter revenues does not drastically change the percentage of appellant's income taxable by California. For example, in 1947, a year of normal commercial operation, appellant had a total payroll of over $11,066,000.00 and the difference in the wage factor as computed by appellant and appellee is only 1.01%.

That use of the "port day" formula rather than the "voyage day" formula does not produce a "drastic" result is dramatically shown by this very case for although appellant's total unitary income subject to apportionment for the six years here involved was approximately $21,000,000.00, the total difference in tax as computed by appellant and appellee is less than $22,000 for the entire period.

THIS APPEAL DOES NOT PRESENT A SUBSTANTIAL FEDERAL QUESTION

I. Due Process Does Not Require the Use of an Allocation Formula Which Operates So as to Allocate a Portion of Appellant's Income to the "High Seas."

It is undisputed that the "port day" formula, when used as an adjunct to the usual three-factor formula of property, payroll and revenues, has the effect or apportioning the unitary income of a steamship company between the various states and countries in which that company does business. Such an apportionment method reflects the extent of the company's activities in California in relation to its total activities in all states and countries in which it does business. Accordingly, California only taxed that portion of a steamship company's unitary income which was fairly attributable to California activities as compared to the company's activities in all the states and countries in which it did business. *Due process requires no more.* There is no constitutional principle granting a company immunity from taxation by any state or country for a portion of its income simply because the company's vessels traverse the "high seas." The clear import of the language of landmark decisions of this Court concerning the power of the several states in regard to taxation of multi-state businesses is that due process is not violated by a fair method of apportionment such as was used by appellee in the present case.

In *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, a case in which a taxpayer attempted to attack a state taxing act on due process grounds, this Court made the following remarks concerning a state's power to tax:

> "The Constitution is not a formulary. It does not demand of states strict observance of rigid categories nor precision of technical phrasing in their exercise

of the most basic power of government, that of taxation. For constitutional purposes the decisive issue turns on the operating incidence of a challenged tax. A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, *it by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society.*

"Constitutional provisions are often so glossed over with commentary that imperceptibly we tend to construe the commentary rather than the text. We cannot, however, be too often reminded that the limits on the otherwise autonomous powers of the states are those in the Constitution and not verbal weapons imported into it. 'Taxable event,' 'jurisdiction to tax,' 'business situs,' 'extraterritoriality,' are all compendious ways of implying the impotence of state power because state power has nothing on which to operate. These tags are not instruments of adjudication but statements of result in applying the sole constitutional test for a case like the present one. *That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the states bears fiscal relation to protection, opportunities and benefits given by the state.* The simple but controlling question is whether the state has given anything for which it can ask return. The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax, and the state has not given the less merely because it has conditioned the demand of the exaction upon happenings outside its own borders. *The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction.*" (311 U.S. 435, 444-5) (Emphasis added)

Although this Court was not there dealing with the precise question presented in this case, the rationale is relevant here. In the above-quoted statement this Court twice enumerated the constitutional principle that due process is satisfied as long as in practical operation the tax in question bears fiscal relation to the protection, benefits, and opportunities afforded by the state by the fact of its being an orderly, civilized society. Clearly, the only orderly, civilized societies which offer or afford any protection, benefits, or opportunities to a steamship company like appellant are the states or countries in which the company does business. No benefits, protection, or opportunities are afforded by the "high seas". Since the method of apportionment here used by appellee was designed to reflect the amount of protection, benefits, and opportunities afforded by California in relation to the total amount of protection, benefits, and opportunities afforded a steamship company, the present tax is within California's taxing power and does not violate the due process limitations set forth in *Wisconsin v. J.C. Penny, supra*.

That due process only requires a fair apportionment between the states and countries in which a company does business was again indicated by this Court in the case of *Northwestern Cement Co. v. Minn.*, 358 U.S. 450, this Court's most recent major decision on the power of a state to tax net income arising from interstate commerce. In the *Northwestern Cement Co.* case the taxpayer contended that the apportioned net income tax there involved violated both the Commerce Clause and the Due Process Clause. This Court disagreed and, after stating the basic principles established under the Commerce Clause, cited the cases of *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271, and *Norfolk & W.R. Co. v. North Carolina*, 297 U.S. 682, and stated that:

> "These cases stand for the doctrine that the *entire net income of a corporation*, generated by interstate as well as intrastate activities, *may be fairly apportioned among the States* for tax purposes by formulas utilizing in-state aspects of interstate affairs." (358 U.S., page 460) (Emphasis added)

Although this Court was there primarily discussing the Commerce Clause, the cases relied upon by the Court are cases traditionally cited as "due process cases".[5] Thus, this Court clearly indicated that the Constitution only requires that the unitary income of a company derived from sources within and without the taxing state be fairly apportioned between the states and counties in which it does business so that the "entire net income" of the company can be taxed once for the support of those jurisdictions which afford the company its total protection, benefits, and opportunities.

Appellee's position is consistent with the cases dealing with apportioned ad valorem property taxes on aircraft used in interstate commerce. *Braniff Airways v. Nebraska Board*, 347 U.S. 590, involved a Nebraska apportioned ad valorem property tax upon airplanes operated both within and without Nebraska. The formula there used by Nebraska to determine the portion of the total value of the aircraft which would be taxed by Nebraska was based on the three factors of arrivals and departures, revenue tons handled at airports, and originating revenues. (347 U.S. page 593, fn. 4) Since none of those factors would allocate any of the value of the aircraft to states over which the aircraft flew but in which they did not land, the effect of that formula is precisely the same as the "port day" formula used by appellee in this case. Although the particular

5. For example, these cases are cited by appellant for the principle that due process prohibits a state from taxing income from extra-territorial sources.

formula there used by Nebraska was not in controversy, this Court held the Nebraska tax to be constitutionally valid. It seems reasonable to say that if a "port day" formula result is constitutional for property tax purposes it would be constitutional for apportionment of unitary net income purposes since the formula as applied for property tax purposes has a more direct effect on the taxpayer than it does for allocation of income purposes.[6]

In addition, Altman and Keesling in their treatise Allocation of Income in State Taxation, 2d Ed. p. 119, state that the method here used by appellee produces the fairest and most logical result. It is significant that these authors found no constitutional objection to the method of apportionment used by appellee in this case.[7]

Appellee's position is supported by logic as well as authority. The following examples demonstrate the illogical results that would flow from an adoption of appellant's position. Consider the situation of two steamship companies, X and Y, both of which are incorporated in New Jersey. X Company operates a steamship line between San Diego, California, and Portland, Oregon. Y Company, using substantially identical vessels and facilities, conducts a similar steamship business between San Francisco, California, and Portland, Oregon. Both companies make one round-trip voyage per month. It is apparent that since San Diego is further from Portland than is San Francisco, the vessels of X Company will be on the "high seas" a

6. In fact, Wisconsin has adopted such a rule for allocation of income purposes for interstate air carriers. The rule has been in effect since 1957 and has not been challenged. (CCH St. Tax Rep., Wisc. ¶ 12-420)

7. Moreover, it is to be noted that appellee's position is in accord with the Uniform Division of Income for Tax Purposes Act. See pages 28-30 of the Brief for Respondent in the District Court of Appeal.

greater number of days than will be the vessels of Y Company. Under appellee's approach, the total unitary net income of both X Company and Y Company can be apportioned between California and Oregon in proportion to the relative activities of the particular company in the two states. This appears logical since it is clear that only California and Oregon offer any benefits or protection to the two companies. Under appellant's analysis, however, a portion of the net income of the two companies is exempt from taxation by *either* California or Oregon. But what is even more illogical in appellant's position is that X Company will have a greater share of its income immune from taxation than will Y Company. It is submitted that constitutional principles of due process are not based on such illogical results, which, in fact, present a rather capricious discrimination in favor of the long haul carrier and against the short haul carrier.[8]

Contrary to the statement contained in appellant's Jurisdictional Statement, appellee's position is not based on the contention that it can tax income from "extraterritorial sources." Rather, appellee's position is that the concept of

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8. Even more unreasonable is appellant's approach as applied to steamship operations solely between California ports. For example, suppose a separate division of a steamship company whose corporate and commercial domicile were elsewhere operating a passenger vessel between Los Angeles, California, and San Francisco, California. It seems only reasonable that California could, consistent with due process, tax the entire net income from those operations. Appellant would apparently argue that a portion of the net income from those operations would be exempt from taxation, the size of said portion depending on the amount of time the vessel was outside the three-mile limit. Likewise, if a company offered daily deep sea fishing trips from San Francisco and return, appellant's analysis would require the finding of a tax immunity for a portion of that company's income if any part of the fishing trip occurred outside the three-mile limit. These are obviously unreasonable results, and there is no indication in any decision of this Court that such a result is required by due process.

"source of income" as used by the courts in relation to taxation of income is a meaningful and useful tool only in relation to the division of income among various taxing jurisdictions. Thus, in relation to the apportionment of the unitary income of a business various indicia of economic activity are considered to ascertain "the source of the income" of the company, i.e., to ascertain what will be an appropriate division of income among the various taxing jurisdictions. While traversing the "high seas" is a necessary incident to the earning of income by a steamship company, it does not follow that the concept of "source of income", which furnishes guidance as to which actual or potential taxing jurisdiction may tax, should also be extended so as to create a vacuum with resulting tax immunity. In this sense, none of the income of appellant had its "source" on the "high seas" any more than the "source" of payments received by appellant was the "high seas."

Appellant fails to cite a single case which deals with the propriety of the apportionment of the income of companies a portion of whose operations occur on or over the "high seas." Instead, appellant merely cites various cases dealing with the propriety of allocating unitary income in general. Not one of the cases cited by appellant remotely suggests that a portion of the income of a steamship company must be attributed to the "high seas" and escape taxation completely.

Thus, appellant attempts to find support for its position in the case of *Central Greyhound Lines v. Mealey*, 334 U.S. 653. It would seem, however, that the logic of this Court's decision in that case would defeat rather than support appellant's position. In that case New York attempted to apply an unapportioned gross receipts tax to revenues obtained with regard to bus trips from one point in New

York to another point in New York but 43% of the mileage of which was in New Jersey and Pennsylvania. This Court held that an unapportioned tax created an unconstitutional burden on interstate commerce because New Jersey and Pennsylvania also had jurisdiction to tax a portion of those revenues. The very basis of the Court's decision was the fact that there was present a jurisdiction able to tax. Since the "high seas" cannot tax, the obstacle present in the *Mealey* case is absent here.

Moreover, setting aside for the moment the question of the theoretical propriety of the "port day" formula versus the "voyage day" formula, it is clear that appellant has not shown that California has taxed more than a fair share of appellant's income. In *Butler Bros. v. McColgan*, 315 U.S. 501 (1942), this Court stated, at page 507,

> "One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed. See *Norfolk & Western Ry. Co. v. North Carolina*, 297 U.S. 682, 688. This Court held in *Hans Rees' Sons v. North Carolina, supra*, p. 135, that that burden had been maintained on a showing by the taxpayer that 'in any aspect of the evidence' its income attributable to North Carolina was 'out of all appropriate proportion to the business' transacted by the taxpayer in that State. No such showing has been made here."

That burden has not been met in this case. This fact was pointed out on pages 32 to 35 of the Brief for Respondent in the District Court of Appeal, wherein it was demonstrated that if a two-factor formula of property and payroll, together with the "voyage day" formula as requested by appellant, were applied to the income of appellant for the years here involved, a greater total tax would have been

due.[9] The schedule illustrating this point, which is attached as an appendix to the Brief for Respondent in the District Court of Appeal, shows that the tax for the years here involved would be $8,217.75 greater.

Our purpose in making this point is not to suggest that appellant should have been taxed in a manner different than it actually was taxed. Rather, it is to point out that the tax that was actually imposed was less than the State could have exacted from appellant under a formula which did attribute income to the "high seas". Thus, it cannot be said that California taxed more than its fair share of appellant's unitary income.

II. The Tax Here Involved Does Not Violate the Commerce Clause.

It has been firmly established that the Commerce Clause does not prohibit a net income tax, such as is present here, on the revenue derived from interstate commerce as long as the tax does not discriminate against interstate commerce "either by providing a direct commercial advantage to local business, *Memphis Steam Laundry v. Stone*, 342 U.S. 389 (1952); *Nippert v. Richmond*, 327 U.S. 416 (1946), or by subjecting interstate commerce to the burden of 'multiple taxation.' *Michigan-Wisconsin Pipe Line Co. v. Calvert*, 347 U.S. 157 (1954); *Adams Mfg. Co. v. Storen*, 304 U.S. 307 (1938)." (*Northwestern Cement Co. v. Minn.*, 358 U.S. 450, at page 458).

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9. Certainly there is no requirement that the formula contain a third factor of revenues. See Barnes, "Prerequisites of a Federal Statute Regulating State Taxation of Interstate Commerce", 46 Virginia Law Review 1269, at 1278; and 49 Amer. Econ. Rev. 398. In fact, since for normal operating years the revenue factor was computed in a manner which had the effect of not allocating any income to the "high seas", the elimination of that factor is consistent with appellant's position.

It is readily apparent that the California tax here in question, levied on income from both interstate and intrastate commerce alike, does not discriminate against interstate commerce. It is equally as apparent that the California tax, apportioned so that in the aggregate no more than 100% of the company's income is taxed by all the states and countries in which it does business, does not subject an interstate business to the burden of multiple taxation. If the method of formula apportionment adopted by appellee and applied to appellant in this case were used by all the jurisdictions in which appellant conducted its business, no more than 100% of appellant's income would be taxed. The method of apportionment here used by appellee to determine California's fair share of appellant's unitary income certainly does not subject appellant to the burden of multiple taxation.

Appellant argues that the method used by appellee "involves a risk" of multiple taxation. That argument is incorrect for, as pointed out above, the formula used by appellee necessarily limits total taxation by all jurisdictions to 100% of appellant's net income. Appellant's argument is based on the assumption that appellee might use some other *hypothetical formula*. In reality, however, it is undisputed that appellee does not now, nor has it ever, claimed that it can apply its income tax to more than its fair share of appellant's net income as measured by appellant's activities in California in relation to appellant's activities in other states and countries.

Moreover, even assuming that there was a "risk" of multiple taxation, appellant's attempt to have the present tax declared invalid must fail for the independent reason that appellant has not even attempted to show that any multiple taxation exists in the present case. Persons attacking the

validity of a tax on the basis that the tax imposes the burden of multiple taxation must prove that such a burden actually exists. (*Northwestern Cement Co. v. Minn.*, 358 U.S. 450, 463)

It is respectfully submitted that appellant's attempt to have the present tax declared invalid by arguing that a formula, not used by appellee, might create a "risk" of multiple taxation lacks merit and falls far short of the burden placed upon taxpayers seeking to invalidate state taxing laws on commerce clause grounds.

As additional argument to support its attempt to have the present tax declared invalid on commerce clause grounds, appellant makes the assertion that the method of apportionment used by appellee discriminates against the long haul carrier. That assertion is incorrect and the example used by appellant to support the assertion is logically inconsistent.

We are here involved with the California net income tax as applied to *carriers* by sea. In the foregoing section we demonstrated that our method treats all such carriers equally—regardless of whether the particular carrier is engaged primarily in short voyages or primarily in long voyages. Thus, two carriers that are engaged in transporation between California and Oregon, with equal port days, shoreside properties, wages, and revenues, will have the same percentage of their income allocated to California whether they operate between Los Angeles and Oregon or San Francisco and Oregon. As a result, the net profit of the two carriers after taxes would be the same. To adopt appellant's approach would result in allocating to California a smaller percentage of income of the long haul carrier with the result that the long haul carrier would have

more money after taxes than would the short haul carrier which had the same taxable net income for the year.

In its Jurisdictional Statement, appellant attempts to support its charge of discrimination by proposing an example of a Washington apple grower and a Washington carrier and comparing them with a New York apple grower and a New York carrier. Appellant's effort in that regard fails to support appellant in that appellant has become so utterly confused by its own example that the factual assumption upon which the example is based is completely inconsistent with the result it attempts to demonstrate. Thus, appellant's example is based on the factual assumption that the New York apple grower may compete in California with the Washington apple grower when the factors of growth and production in New York are sufficiently more favorable than in Washington so as to offset the higher cost of transportation from New York. But if that is true, i.e., if the New York apple grower can get his apples to market in California for the same total cost as the Washington apple grower, the two growers can fairly compete in the California market place and it cannot be charged that California has placed a burden on the New York apple grower, regardless of how the net income of the carriers they hired to transport their apples is apportioned for purposes of state taxation. The fact that California would tax the same proportion of the net income of both the carrier hired by the Washington apple grower and the carrier hired by the New York apple grower certainly does not create a competitive advantage for the Washington grower.

Appellant's contention that it discriminates against the New York apple grower to tax all carriers on an equal basis is patently fallacious. Appellant's statement that "the tax cost per ton of apples shipped for the New York producer

is almost 10 times that for the Washington producer", even if it were literally true, would not show discrimination against the long haul carrier. Obviously the figure which is reached by dividing the carriers total yearly tax by the number of units carried must be higher in the case of the long haul carrier than it will be in the case of the short haul carrier—this naturally follows from appellant's assumed fact that the New York carrier makes as much net income per year as does the Washington carrier. But simply because one carrier makes more net income per voyage than another carrier (and therefore pays a higher net income tax) does not mean that the carrier is being discriminated against.

Moreover, appellant's reference to "tax cost" per ton of apples indicates appellant's belief that the net income tax paid by the carrier somehow creates a burden on the apple grower. Appellant is completely unwarranted in assuming that a net income tax on the carrier has the same effect as a tax imposed on the producer. To the contrary, this Court has specifically refused to judicially assume that a net income tax is "passed on" to persons dealing with the person taxed. (*Graves et al. v. New York ex rel. O'Keefe*, 306 U.S. 466 (1939), holding that the effect of a state net income tax on the salary of a federal employee was "a theoretical advantage, speculative in character and measurement and too unsubstantial" to be considered a burden on the federal government.)

It is submitted, therefore, that equal treatment of all carriers which do business in California does not constitute discrimination against the customer of the carrier which is engaged in primarily long haul voyages.

CONCLUSION

For the reasons set forth above, the allocation formula used by appellee is constitutional in all respects and the appeal from the decision of the California District Court of Appeal upholding the formula does not present any substantial federal questions. Accordingly, it is respectfully submitted that this appeal should be dismissed or, in the alternative, the decision of the California District Court of Appeal should be affirmed.

Respectfully submitted,

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